Nos. 04-1704, 04-1724

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IN THE

Supreme Court of the United States

DAIMLERCHRYSLER CORPORATION, *et al.*,
Petitioners,

v.

CHARLOTTE CUNO, *et al.*,
Respondents.

WILLIAM W. WILKINS, *et al.*,
Petitioners,

v.

CHARLOTTE CUNO, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF OF *AMICI CURIAE* ALPHAGENICS, INC., GREATER BALTIMORE TECHNOLOGY COUNCIL, MDBIO, INC., TECHNOLOGY COUNCIL OF MARYLAND, UPSTATE VENTURE ASSOCIATION OF NEW YORK, INC., AND 20/20 GENESYSTEMS, INC. IN SUPPORT OF PETITIONERS

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Dated: December 5, 2005

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STATEMENT OF PARTIES SUPPORTED BY THIS BRIEF

This Brief *amicus curiae* is filed in support of the Petitioners.[1] The opinion of the United States Court of Appeals for the Sixth Circuit (the "Court of Appeals") is reported at 386 F.3d 738 (6th Cir. 2004). Petitioners DaimlerChrysler Corporation and Wilkins, et al., have consented to the filing of this Brief pursuant to letters of Consent to the Filing of Amicus Briefs in Support of Either Party lodged with the Clerk on October 24, 2005. Respondents have consented to the filing of this Brief pursuant to a letter of consent on file with the Clerk.

IDENTITY AND INTEREST OF *AMICI CURIAE*

The *amici* include associations of companies and other interested groups engaged in bioscience-based businesses and high technology and those comprised of potential investors in such enterprises. The membership of the Technology Council of Maryland and the Greater Baltimore Technology Council includes not only publicly traded multinational companies but also companies in technology incubators engaged in cutting-edge innovation in fields such as biotechnology, information technology, software, nanotechnology, and advanced materials. The mission of the nonprofit MdBio, Inc. is to unify, empower and advance Maryland's bioscience industry, promoting

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[1] In accordance with rule 37.6, Counsel for the *amici* states that no counsel for any party has authored this brief in whole or in part, and no person or entity, other than the *amicus*, has made a monetary contribution to the preparation of this brief. University of Maryland School of Law students David Blazina, Aimée Drouin, Oliver Edwards, Kristine Grigorian, Joanne Hawana, Phillip Heller, James Knight, Winston Martindale, Enyinnaya Obi, Kelley Walsh, and Yue Zhu, student attorneys at the Maryland Intellectual Property Legal Resource Center, assisted in the preparation of this Brief.

corporate and economic development. AlphaGenics, Inc. and 20/20 Genesystems, Inc. are two emerging technology companies located at the Maryland Technology Development Center in Rockville, Maryland.

Maryland enacted the Biotechnology Investment Incentive Act in 2005. This Act provides limited income tax credits to investors in Maryland biotechnology companies. 2005 Md. Laws ch. 99. On April 28, 2005, the Attorney General of Maryland wrote to the Governor stating that the then-proposed legislation might violate the Commerce Clause.[2] Although the letter asserted that the decision of the Court of Appeals in this action was "not relevant to the issues raised by House Bill 664" as it then existed,[3] it also declared, "The *Cuno* case is the most far-reaching . . . in that it reaches tax credits available to out-of-state companies based on activities and job creation in the State . . . ."[4] The Attorney General's letter raises the distinct possibility that the decision of the Court of Appeals could result in invalidating the Maryland statute even if the Legislature addressed the issues the letter identified. This prospect has had an unsettling effect on the investment climate for early-stage biotechnology companies in Maryland.

Fledgling biotechnology companies experience enormous cash "burn rates" and encounter lengthy delays to commercialization because of the need to obtain patent protection and regulatory approvals. The decision of the Court of Appeals has cast a substantial cloud over the tax incentives that Maryland and most other states use to enhance their economic futures and promote innovation by nurturing their home-grown emerging technology companies and

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[2] Letter, dated April 28, 2005, from J. Joseph Curran, Jr., Attorney General of Maryland, to Governor Robert L. Ehrlich (attached as Exhibit).

[3] *Id.* at 3, note 3.

[4] *Id.*

reducing the risk to potential investors. There is a substantial probability that the uncertainty engendered by the decision below will exacerbate the already difficult task of emerging yet fragile enterprises such as AlphaGenics and 20/20 to raise capital from the private equity markets.

The Upstate Venture Association of New York, Inc. ("UVANY") is a group whose membership includes venture capital firms, private equity investors and financial institutions from New York and other states interested in promoting deal flow and investment in technology companies across New York. UVANY has member firms that have already invested or are considering investing in such companies.

In 2005, New York enacted a refundable research and development tax credit. 2005 N.Y. Laws ch. 61. UVANY is concerned that affirmance of the decision of the Court of Appeals will put the New York development tax credit and other tax measures designed to assist early-stage technology companies in New York at serious risk.

SUMMARY OF ARGUMENT

Innovation is expensive, and funding is its life-blood. Without resources to allow emerging technology companies to press forward with the development of new products and services to meet important societal needs, entrepreneurship and the engine for job creation it represents would be dealt a severe blow. Maintaining the lead that the United States currently enjoys in technology innovation against growing foreign competition is an important national priority. Many states, including Maryland and New York, have staked their economic futures and invested vast sums in achieving and maintaining leadership in this increasingly vital sector of the economy. Entrepreneurship has become an important component of business, engineering, and other academic

programs,[5] and venture capital and angel investing can now be found in many developed and developing countries.[6]

Against this backdrop of increasing interest in and support for technology commercialization, and the emerging companies at the forefront of these efforts, Respondents' suit represents a frontal assault on all state tax credit mechanisms used for economic development purposes. In the words of one of the architects of this action, it represents "pathbreaking litigation to combat corporate welfare."[7] However, in attacking a non-discriminatory economic development program used by the vast majority of states, this "pathbreaking litigation" suffers from two fatal flaws.

As an initial proposition, but one that disposes of this action completely, Respondents, with their attenuated interests and hypothetical and speculative injuries and unlikelihood of obtaining redress by a favorable decision, lack standing under Article III to avail themselves of the judicial power of the United States to challenge the Ohio statute.

Secondly, even if this Court were to find that any of the Respondents has standing, Respondents ask this Court to stray from its traditional case-by-case analysis of dormant Commerce Clause cases in at least two ways: First, the

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[5] *See, e.g.*, Jim Hopkins, *Venture capital 101: Entrepreneur courses increase*, USA TODAY, Jan. 5, 2004 (Ewing Marion Kauffman Foundation recently awarded $25 million to eight U.S. universities pledging to spread entrepreneurship education beyond business classrooms), at 1B, *available at* 2004 WLNR 6209380.

[6] *See, e.g.*, Jitendra Uttam, *Convergence of Finance, Technology and Entrepreneurship: The Role of Liberal Financial System in the Making of India's New Economic Growth Regime*, JOURNAL OF INTERNATIONAL AND AREA STUDIES, § 6 (June 1, 2005), *available at* 2005 WLNR 14739829.

[7] Northeastern School of Law Faculty website profile of Peter D. Enrich *at* http://www.slaw.neu.edu/faculty/f_enrich.htm, last viewed Nov. 23, 2005.

Respondents are asking this Court to act as a super-legislature to judge the wisdom of state tax credits as economic development incentives. Although this subject is open to debate, this Court has stated repeatedly that the state Legislatures are the proper forums to make such decisions. *See, e.g., Day-Brite Lighting, Inc. v. Missouri*, 342 U.S. 421, 423 (1952) (concluding "[o]ur recent decisions make plain that we do not sit as a super-legislature to weigh the wisdom of legislation nor to decide whether the policy which it expresses offends the public welfare."). Indeed, the rationale behind this action runs counter to the notion this Court has expressed numerous times that the states are laboratories and should be given wide latitude to fashion innovative programs that meet their particular needs. *See, e.g., Reeves, Inc. v. Stake*, 447 U.S. 429, 441 (1980) (holding "[i]t is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory, and try novel social and economic experiments without risk to the rest of the country.").

Notwithstanding these fatal defects in Respondents' strategy, the mere fact that they have brought this suit inevitably raises serious questions about the legal status of state tax credit programs and contributes to an environment of uncertainty among entrepreneurs and investors alike. To the extent that this atmosphere increases the risk of failure to fragile emerging companies, innovation will suffer.

The interests of the members of *amici* associations that are large companies have been expressed persuasively in the Briefs for Petitioners and in other *amicus* Briefs. This Brief, therefore, will concentrate on the unique considerations of the emerging technology community. Nevertheless, all members of the *amici* associations benefit from the presence in their states of vibrant, well-funded emerging technology companies.

ARGUMENT

I. Respondents Do Not Have Standing to Challenge Ohio's Investment Tax Credit.

This Court, *sua sponte*, directed the parties to brief and argue, "Whether respondents have standing to challenge Ohio's investment tax credit, OHIO REV. CODE ANN. § 5733.33." *DaimlerChrysler Corp. v. Cuno*, 126 S. Ct. 36 (2005). Thus, this Court has made standing a critical threshold question in deciding this action.

Under Article III, standing emanates from the "case or controversy" requirement and the separation of powers. *Allen v. Wright*, 468 U.S. 737, 750 (1984) (quoting *Warth v. Seldin*, 422 U.S. 490, 498 (1975)). The federal courts may exercise power "only when adjudication is 'consistent with a system of separated powers and [the dispute is one] traditionally thought to be capable of resolution through the judicial process.'" *Allen*, 468 U.S. at 752 (alteration in original); *see Lujan v. Defenders of Wildlife*, 504 U.S. 555, 559-60 (1992). To establish standing under Article III, Respondents must demonstrate that they have suffered an injury in fact, that they are within the zone of interests protected by the Commerce Clause, and that it is likely that a favorable decision will provide redress to Respondents. Respondents fail under all three prongs. *Associated Data Processing Serv. Orgs. v. Camp*, 397 U.S. 150, 154 (1970); *Lujan*, 504 U.S. at 561.

A. Respondents Have Not Suffered an Injury In Fact.

First, each of the Respondents must show that he or she has suffered an "injury in fact, economic or otherwise," caused by the Ohio investment tax credit that would constitute an invasion of a "concrete and particularized"

legally protected interest. *Associated Data Processing*, 397 U.S. at 152; *Lujan*, 504 U.S. at 560. Respondents claim injury as taxpayers because the Ohio investment tax credit has purportedly led (or will lead) to a reduction in funding for the City of Toledo and the local school systems. Compl. ¶ 22. However, the Commerce Clause does not eclipse the reserved power of the states to tax for the support of their own governments and to deploy resources within the states as their legislatures deem necessary. *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 42 (1824). Respondents merely contend that they are injured by the investment tax credit, but in vague, hypothetical, and generalized ways. Their Complaint does not allege any particularized injury necessary to establish a basis for standing.[8]

Significantly, Peter Enrich, who briefed and argued the case on behalf of the Respondents in the Court of Appeals, has conceded that taxpayers bringing these types of claims against state tax incentives would have only an "attenuated" interest in the outcome of such litigation. Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 413 (1996). ("Whereas a business plaintiff can claim a direct and particularized interest in the outcome . . . the citizen/taxpayer plaintiff's interest is more attenuated.")[9]

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[8] The Michigan Respondents claim injury in fact because of some possibility that absent the Ohio investment tax credit, OHIO REV. CODE ANN. § 5733.33, the Petitioner might have located its factory in Michigan. Compl. ¶ 42. Michigan Respondents have no nexus with Ohio. The Michigan Respondents' alleged injury is entirely speculative and even less particularized than the injury alleged by the Ohio Respondents.

[9] Respondent Kim's Auto and Truck Service, Inc. claims injury in fact by alleging that without Ohio's investment tax credit, the Petitioner would not have expanded its Toledo plant. Compl. ¶ 41. This Respondent's business was displaced because of the expansion. However, a jury awarded Kim's $104,000 as compensation in Kim's takings case against

B. Respondents Are Not Within the Zone of Interests Protected by the Commerce Clause.

Even assuming *arguendo* that Respondents had sustained an injury in fact, the second prong of the standing standard rests on whether the investment tax credit "provision [was] intended to benefit the putative plaintiff." *Dennis v. Higgens*, 498 U.S. 439, 449 (1991). Respondents allege that the Ohio investment tax credit violates the dormant Commerce Clause. However, the "very purpose of the Commerce Clause was to create an area of free trade among the several States." *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 328 (1977). "The [Commerce] Clause was intended to benefit those who . . . are engaged in interstate commerce." *Dennis*, 498 U.S. at 449. Respondents do not allege that they are engaged in interstate commerce. The Commerce Clause does not permit states to enact taxes that "discriminate[] against interstate commerce . . . by providing a direct commercial advantage to local business." *Bacchus Imps. v. Dias*, 468 U.S. 263, 268 (1984) (ellipsis in original) (quoting *Boston Stock Exch.*, 429 U.S. at 329). "For over 150 years, our cases have rightly concluded that the imposition of a differential burden on any part of the stream of commerce – from wholesaler to retailer to consumer – is invalid, because a burden placed at any point will result in a

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the City of Toledo. *City of Toledo v. Kim's Auto & Truck Service, Inc.*, No. L-02-1318, 2003 WL 22390102 (Ohio Ct. App. Oct. 17, 2003). Kim's appealed to the Ohio Court of Appeals, which rejected Kim's "public use" argument and affirmed the jury award. *Id.* The Supreme Court of Ohio and then this Court denied further review. *Toledo v. Kim's Auto & Truck Serv., Inc.*, 101 Ohio St. 3d 1469, 804 N.E.2d 42 (2004); *Kim's Auto & Truck Service, Inc. v. City of Toledo, Ohio*, 125 S. Ct. 2988 (2005). Kim's has fully litigated its takings case and has thus obtained complete relief for any injury. Even if this Court were to grant the relief the Respondents seek, Kim's business would not be restored to its previous location and status.

disadvantage to the out-of-state producer." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 202 (1994).

Unlike Respondents, the plaintiffs who challenged the New York stock transfer tax in *Boston Stock Exchange* had "assert[ed] their right under the Commerce Clause to engage in interstate commerce free of discriminatory taxes on their business and they alleg[ed] that the transfer tax indirectly infringes on that right." *Boston Stock Exch.*, 429 U.S. at 321. The stock transfer tax was within the "zone of interests" protected by the Commerce Clause because the differential cost of the tax depended on the geographic location of the stock exchange as well as the location of the owner of the stock. *Id.* The Ohio investment tax credit is available and equally applied to both in-state and out-of-state businesses. Because Respondents have no connection with the stream of commerce, they do not fall within the zone of interests protected by the Commerce Clause.

C. Any Redress of Respondents' Alleged Injuries is Purely Speculative.

Finally, to establish standing under Article III, Respondents must demonstrate that their injury will "likely be redressed by a favorable decision." *Simon v. Eastern Ky. Welfare Rights Org.*, 426 U.S. 26, 38 (1976). Even if this Court were to affirm the decision of the Court of Appeals, there is no assurance that the allegedly adverse consequences emanating from the tax credit would be remedied. Respondents have suffered no injury in fact, do not fall within the zone of interest protected by the Commerce Clause, and any chance of redressability appears speculative at best.

At a constitutional minimum, Respondents need to establish all three elements of standing before the merits are reached. *Lujan*, 504 U.S. at 560. In fact they are able to meet

none of them. Because standing in the constitutional sense is an essential prerequisite for the exercise of federal judicial power under Article III, the absence of standing by the Respondents is sufficient in itself for this Court to reverse the judgment of the Court of Appeals and direct that this action be dismissed.[10] *Linda R.S. v. Richard D.*, 410 U.S. 614, 616 (1973).

II. Ohio's Investment Tax Credit Is Compatible with the Commerce Clause Because It Is a Non-Discriminatory Initiative to Encourage Investment in the State.

If this Court determines that any of the Respondents has standing to challenge the Ohio investment tax credit, this Court will address the merits of the decision of the Court of Appeals that held that the tax credit violates the dormant Commerce Clause. For the reasons that follow, that decision is wrong and should be reversed.

A. The Court of Appeals Misapplied the Decisions of this Court in Invalidating Ohio's Investment Tax Credit.

The Constitution grants Congress the exclusive right to regulate interstate and foreign commerce. U.S. CONST. art. I, § 8, cl. 3. This Court has interpreted the negative or "dormant" portion of the Commerce Clause to limit a state's

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[10] Ohio's standards for conferring standing follow those that this Court has enunciated for the federal courts. *See, e.g., State ex rel. Ohio Acad. of Trial Lawyers v. Sheward*, 86 Ohio St. 3d 451, 469-70, 715 N.E.2d 1062, 1081 (1999), ("In order to have standing to attack the constitutionality of a legislative enactment, the private litigant must generally show that he or she has suffered or is threatened with direct and concrete injury in a manner or degree different from that suffered by the public in general, that the law in question has caused the injury, and that the relief requested will redress the injury."). It is thus apparent that Respondents lacked standing to bring this suit in the Ohio courts, as they had done originally.

ability to regulate interstate commerce. A state tax is allowed only when the "tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Complete Auto Transit v. Brady*, 430 U.S. 274, 279 (1977). Although the dormant Commerce Clause does not prohibit a state from regulating business within the state, it does restrict a state from engaging in economic protectionism such as unfair taxation of out-of-state transactions.

This Court has repeated consistently that the Commerce Clause constrains a state from regulating commerce in a way that creates barriers to commerce outside the state. *See, e.g., GMC v. Tracy*, 519 U.S. 278, 287 (1997). Yet this Court has also been careful not to tie the hands of states in exercising their taxing powers to promote in-state economic development or to provide special incentives to investment in disadvantaged areas or to targeted sectors of the economy. "We have acknowledged that the delicate balancing of the national interest in free and open trade and a State's interest in exercising its taxing powers requires a case-by-case analysis and that such analysis has left 'much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation.'" *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 403 (1984) (quoting *Boston Stock Exch.*, 429 U.S. at 329).

The absence of a precise guide and the adoption by this Court of a careful case-by-case analysis is manifest in the cases the Court of Appeals has cited in its opinion. *See Cuno v. DaimlerChrysler Corp.*, 386 F.3d 738, 744-45 (6th Cir. 2004). The Court of Appeals relied heavily on *Boston Stock Exchange*, in which this Court declared that a New York statute that imposed a greater tax liability on out-of-state stock transactions violated the Commerce Clause. While

holding that the New York statute unduly burdened interstate commerce, this Court was careful to state, "[o]ur decision today does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry." 429 U.S. at 336. This Court emphasized that a state tax credit must be nondiscriminatory by stating, "[w]e hold only that in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State." *Id.* at 337.

Indeed, this Court has been careful not to limit a state in assisting the growth of in-state industry and commerce. Lower tax rates have been specifically mentioned as permitted incentives: "it is undisputed that States may try to attract business by creating an environment conducive to economic activity, as by maintaining good roads, sound public education, or low taxes." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 199 (1994); *see also Zobel v. Williams*, 457 U.S. 55, 67-68 (1982) (Brennan, J., concurring) ("a State may make residence within its boundaries more attractive by offering direct benefits to its citizens in the form of public services, lower taxes than other States offer, or direct distributions of its munificence."); *id.* at 72, note 1 (O'Connor, J., concurring) ("a State might enact a tax credit for citizens who contribute to the State's ecology by building alternative fuel sources or establishing recycling plants."); *Bacchus Imps.*, 468 U.S. at 271 ("[n]o one disputes that a State may enact laws pursuant to its police powers that have the purpose and effect of encouraging domestic industry."); *Metro. Life Ins. Co. v. Ward*, 470 U.S. 869, 878 (1985) (per curiam) (restating that promotion of local industry is a legitimate state interest in the Commerce Clause). Nevertheless, the Court of Appeals failed to address this point, focusing instead only on the permissibility of direct subsidies to businesses. *Cuno*, 386 F.3d at 746.

The purpose of the Commerce Clause is not to limit a state's ability to effect policies to promote industry and economic growth within the state, but rather to limit a state's ability to affect interstate commerce by discriminatory taxation. The language and concept of burdened and benefited parties is derived from *Bacchus Imps.*, 468 U.S. at 273. The Court of Appeals quoted from *Bacchus Imports* in support of its decision: "The determination of constitutionality does not depend upon whether one focuses upon the benefited or the burdened party." *Id.* at 273. However, this quotation by the Court of Appeals omitted the next sentence—one which provides a limit to that determination of constitutionality: "A discrimination claim, by its nature, requires a comparison of the two classifications." *Id.* at 273. A comparison allows investigation into one of the factors articulated in *Complete Auto Transit*, the discriminatory effect on interstate commerce of a tax statute.

Unlike the New York stock transfer tax in *Boston Stock Exchange*, which unduly burdened out-of-state transactions, the Ohio investment tax credit benefits all transactions taking place within Ohio. The Court of Appeals did not compare the benefited and burdened parties. Rather, it simply reached a categorical conclusion that tax credits involve regulation of interstate commerce, and thus violate the dormant Commerce Clause. This comparison, which the Court of Appeals failed to make, is crucial for emerging technology companies because they are legitimate beneficiaries of direct or indirect in-state economic development incentives to promote their growth and prosperity and to create jobs.

B. The Dormant Commerce Clause Does Not Foreclose Ohio's Investment Tax Credit or Any Similar Tax Credit Legislation.

Boston Stock Exchange does not contemplate a prohibition on tax incentives as broad as the Court of Appeals adopted. *Boston Stock Exchange* explicitly states that the decision should not be interpreted to invalidate state tax incentives encouraging intrastate economic development. *See* 429 U.S. at 336.

The key distinction between the tax strategies invalidated in *Boston Stock Exchange*, *Bacchus*, and *Westinghouse* and that employed by Ohio is the presence of burdens on out-of-state business and activities in the cited cases, and the absence of such burdens in this action. The Court of Appeals stated that Ohio's investment tax credit burdened interstate commerce by "coercing" companies to remain in Ohio. *See Cuno*, 386 F.3d at 746, note 1. However, the Court of Appeals did not—and could not—substantiate any burdensome effect because "coercion" cannot be found: the investment tax credit operates only prospectively. Indeed, Justice Stevens has written, "[n]or, in my judgment, does [the Commerce] Clause inhibit a State's power to experiment with different methods of encouraging local industry. Whether the encouragement takes the form of a cash subsidy, a tax credit, or a special privilege intended to attract investment capital, it should not be characterized as a 'burden' on commerce." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 816 (1976) (Stevens, J., concurring). The investment tax credit is a method that Ohio has adopted to promote economic development and to encourage investment and job creation in economically disadvantaged areas such as Toledo. It does not burden out-of-state business.

III. Affirmance of the Decision of the Court of Appeals Will Interfere with the Ability of States to Enhance Their Economic Prospects, Promote Innovation, and Encourage Investment in Their Technology Sectors.

A. Entrepreneurs and Emerging Businesses in the Technology Sector Will Suffer from the Instability in the Capital Markets that Will Ensue from Affirmance of the Decision Below.

Start-up and early-stage companies are engines of growth and provide great potential for local and regional economies. Nearly 70 percent of economic growth is attributed to such companies, and they are responsible for creating two-third of all new jobs.[11]

Although start-up and early-stage companies are critical for economic growth, they encounter substantial difficulty obtaining funding. Good business ideas often are unfulfilled because the entrepreneur cannot increase the initial $5,000 to $500,000.[12] Early funding usually comes from family and friends and is usually insufficient to keep the business running until additional sources can be identified and convinced to invest.

In contrast, the source of funding least available to start-up and early-stage companies is institutional venture capital. Institutional investors typically do not invest in such companies, generally because it is not financially feasible to

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[11] PHIL PSILOS, ET AL., A GOVERNOR'S GUIDE TO STRENGTHENING STATE ENTREPRENEURSHIP POLICY 4, 6 (2004), *available at* http://preview.nga.org/Files/pdf/0402GOVGUIDEENTREPRENEUR.pdf.

[12] John Torinus, *State needs daring measures to get new businesses up, running*, JOURNAL SENTINEL (Milwaukee), Sept. 20, 2003, at P03, *available at* http://www.jsonline.com/bym/news/sep03/171158.asp.

make investments of the size these companies require.[13] For example, the University of Wisconsin Foundation has more than $1 billion in assets under management but does not invest directly in companies.[14]

In 2003, the total institutional investment in entrepreneurial ventures totaled $18.2 billion, but only $304 million of that went to seed and start-up stage companies.[15] Fewer than one in every ten thousand start-up companies received its initial financing from venture capital firms.[16]

Angel investors play an important role in funding companies in phases between individual and institutional investment.[17] Angel investors, individuals having substantial personal assets and a desire to invest in local start-up businesses, are increasingly recognized as a critical component to a state's entrepreneurial community.[18] More than 300,000 angel investors were estimated to have invested approximately $30 billion in 2002 in over 50,000 deals, far outpacing the institutional venture capital market.[19]

For early-stage companies, location decisions are based on factors such as family considerations, access to faculty, facilities, and other resources of affiliated research

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[13] Tom Still, *Investment tax credit bill is a good start, but Wisconsin must confront other barriers to capital formation* (Apr. 21, 2004), *at* http://wistechnology.com/article.php?id=771.

[14] *Id.*

[15] Maria Minniti & William D. Bygrave, Global Entrepreneurship Monitor, National Entrepreneurship Assessment • United States of America, 2003 Executive Report 7 (2004), *available at* http://www.gemconsortium.org/download.asp?fid=355.

[16] William D. Bygrave & Stephen A. Hunt, GEM Financing Report 2004 20 (2005), *available at* http://www.gemconsortium.org/download.asp?fid=365.

[17] PSILOS, *supra* note 11, at 27.

[18] *Id.*

[19] *Id.*

institutions, suitable and affordable space, availability of skilled managers and workers, and eligibility for business assistance and economic development incentives. Even a cursory review of the weekly electronic newsletter of the National Association of Seed and Venture Funds[20] reveals that nowhere is the variety of economic development models and the importance of states' ability to experiment with different incentives to attract individual and institutional investment more evident than in the emerging technology sector.

The types of tax credits that are most beneficial to emerging technology companies are those that are refundable, those that can be carried forward to periods in which the company can reasonably expect to offset them against taxable income, or those that provide an indirect benefit by reducing the risk to potential investors and thus facilitating the ability to obtain funding. In that sense, such tax credits, as well as the Ohio investment tax credit, are the functional equivalents of subsidies. Even the Court of Appeals acknowledged that subsidies are consistent with the Commerce Clause. *Cuno*, 386 F.3d at 742.

An increasing number of states, including Maryland, offer tax credits to angel and institutional investors. *See, e.g.*, MD. CODE ANN., TAX-GEN. § 10-725 (LexisNexis Supp. 2005). Virginia, Maine, Vermont and West Virginia offer credits of up to 50 percent of investments subject to certain limitation. VA. CODE ANN. § 58.1-339.4 (2004 & Supp. 2005), ME. REV. STAT. ANN. tit. 10 § 1100-T (Supp. 2005), VT. STAT. ANN. tit. 32, § 5930k (Supp. 2005), W. VA. CODE § 11-13C-7a (2003). Hawaii offers to qualifying high-technology businesses a tax credit which can cumulate over five years to 100 percent of an investment. HAW. REV. STAT. ANN. § 235-110.9 (LexisNexis Supp. 2005).

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[20] NASVF NetNews, *at* http://www.nasvf.org/web/netnews.nsf.

Tax credits can confer benefits to emerging technology companies in addition to encouraging angel and institutional investment. Refundable investment and R&D tax credits such as those enacted by New York in 2005, may assist start-up and early-stage companies in obtaining bank loans. For example, Canadian banks are willing to lend to start-up companies using their refundable investment tax credit as collateral.[21] Such loans can be made for up to 75 percent of the federal refundable investment tax credit.[22]

State tax investment incentives are thus crucial in helping local start-up and early-stage businesses, and play an important role in creating future economic growth and new jobs. In addition, because start-up companies are important sources of new ideas and technologies, state tax investment incentives such as Ohio's investment tax credit promote innovation. This is critical for the future of not only Ohio but of the United States as a whole.

B. Invalidating Ohio's Investment Tax Credit and Similar Statutes in Other States Will Not Level the Playing Field but Instead Will Siphon Investment to Countries that Offer Such Incentives.

Like Ohio's tax incentive, most state tax credit incentives restrict the tax credit to the in-state activities. Alabama, for example, provides an income tax credit for new investment in Alabama, ALA. CODE § 41-23-24(a) (2000); Arizona provides an income tax credit for taxpayers who increase in-state research activities, ARIZ. REV. STAT. ANN. § 43-1168 (Supp. 2005); Connecticut provides an income tax credit for investing in certain new manufacturing facilities in

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[21] Scotiabank - Investment Tax Credit Loan, *at* http://www.scotiabank.com/cda/content/0,1608,CID361_LIDen,00.html (last visited Nov. 29, 2005).

[22] *Id.*

Connecticut, CONN. GEN. STAT. ANN. § 12-217e (West 2000); Missouri provides an income tax credit for investing in small business in Missouri, MO. ANN. STAT. § 135.400-33 (West 2000 & Supp. 2005); and Maryland provides an income tax credit for investing in biotechnology companies, MD. CODE. ANN., TAX-GEN. § 10-725 (2005).

As already discussed, the decision of the Court of Appeals will result in the unintended consequence of impeding innovation among early-stage companies and impacting on entrepreneurship. Moreover, it will influence the location of facilities and operations by those technology companies that achieve profitability. Many nations and their political subdivisions already offer tax credits that are more attractive than the Ohio investment tax incentive struck down by the Court of Appeals. Such countries are already attracting American companies because of these incentives. This Court should consider the effects of restricting state tax credit incentives on the future competitiveness of the United States.

The United States now faces robust competitive challenges from China, Canada, India, Ireland, Taiwan, South Korea, Singapore, and other countries. These countries see their futures tied directly to becoming powerhouses in technology and innovation, primarily at the expense of the United States. Therefore, states must be permitted to develop programs with a keen awareness of the efforts being made by other countries to compete for technology, facilities, and jobs. The Council on Competitiveness examined foreign incentive packages as part of the National Innovation Initiative ("NII"). The NII called upon "[m]ore than 400 leaders and scholars from universities, corporations, professional societies, industry associations,

and government."[23] The NII's final report, "Innovate America," states that "America's [collective] challenge is to unleash its innovation capacity. . . . At a time when macro-economic forces and financial constraints make innovation-driven growth a more urgent imperative than ever before."[24] The NII outlined the "unprecedented acceleration of global change . . . fierce competition from countries that seek an innovation-driven future for themselves."[25] One of the necessary solutions the NII proposed is that the Government should increase the availability of early-stage risk capital with tax incentives, expanded angel networks, and state and private seed capital funds.[26]

The NII Report warned that "Sweden, Finland, Israel, Japan, and South Korea each spend more on R&D as a share of GDP than the United States."[27] "China overtook the United States in 2003 as the top global recipient of foreign direct investment."[28] "Only six of the world's 25 most competitive information technology companies are based in the United States; 14 are based in Asia."[29]

States wishing to enhance the economic welfare of their citizens must consider innovative incentive packages for technology companies and potential investors in light of incentives offered by foreign competitors. "The government of Canada is modifying the [Scientific Research & Engineering Development] credit mechanism to make it more attractive to foreign investors on an after-tax basis, taking account of the foreign investor's home country tax laws in

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[23] COUNCIL ON COMPETITIVENESS, INNOVATE AMERICA: NATIONAL INNOVATION INITIATIVE REPORT 13 (2004).
[24] *Id.* at 5.
[25] *Id.*
[26] *Id.* at 35-36.
[27] *Id.* at 12.
[28] *Id.*
[29] *Id.*

order to increase investment in Canadian-based R&D, without reducing the government's net tax revenues."[30] This change, which is still draft legislation, should help a number of venture capital funded high-tech start-ups.[31]

South Korea's 2004 tax reform included several measures to boost corporate investment, including a reduction in the alternative minimum tax rate for small and medium-sized enterprises, and an extension and increase in the temporary investment tax credit for capital spending.[32]

Firms investing at least NT$25 million and increasing employment by at least 50 persons in underdeveloped Taiwanese regions are eligible for a tax credit equal to twenty percent of new investment.[33] Alternatively, they may choose not to pay corporate income tax for the specific year the investment is approved.[34]

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[30] David V. Daubaras, *Scientific Research & Experimental Development*, TAX EXECUTIVE, Nov. 1, 2004, at § 15, *available at* 2004 WLNR 16849433.

[31] Denis Lajoie, *Canada's Scientific Research and Experimental Development Program is in a State of Continuous Improvement with a Number of Recent Evolutions*, CA MAGAZINE, Aug. 1, 2005 *available at* 2005 WLNR 13911470.

[32] Economist Intelligence Unit, *Country Commerce South Korea 2004/2005 Main Report*, COUNTRY COMMERCE, July 30, 2004, *available at* 2004 WLNR 13972426.

[33] Economist Intelligence Unit, *Country Commerce Taiwan, Incentives: Regional Incentives*, COUNTRY COMMERCE, July 30, 2004, *available at* 2004 WLNR 15862193.

[34] Taiwan also offers specialized industrial parks in which, for example, companies may enjoy a five-year tax holiday, import-duty exemption, and a 20% ceiling on corporate income tax for investments in the manufacture of precision instruments, machinery and electronics. Also, a special 15% investment-tax credit, which may be deferred for up to four years, is available to companies undergoing capital expansion. More than 375 companies have commenced operations in one such park including 159 integrated-circuit manufacturers, 54 telecommunications firms, 60 opto-electronics firms, 57 computer and peripherals makers, 27 biotechnology companies, and 21 precision-machinery manufacturers. Fifty-seven are

As related to early-stage technology companies, state tax credit incentives to promote in-state R&D, investment and job creation in the technology sector are the opposite of "corporate welfare." These incentives do not discriminate against interstate commerce and are essential to promote innovation and enhance the long-term economic growth not only of each state but also the entire United States. Such incentives are at the very core of what the Commerce Clause was intended to create: an economic union of the states in which the success of each benefits all. *See Boston Stock Exch.*, 429 U.S. at 328. The decision of the Court of Appeals, which reached the opposite conclusion, is plainly wrong and should be reversed.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals holding that the Ohio investment tax credit, OHIO REV, CODE ANN. § 5733.33, violates the Commerce Clause should be reversed and the action dismissed.

Respectfully Submitted.

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Dated: December 5, 2005

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foreign companies including Royal Philips Electronics, Mitsubishi, Shin-Etsu Optoelectronics, Taisil Electronic Materials, Hewlett-Packard, Motorola, Logitech, and Siemens. Economist Intelligence Unit, *supra* note 33.

EXHIBIT

MD 069

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April 28, 2005

The Honorable Robert L. Ehrlich, Jr.
Governor of Maryland
State House
Annapolis, Maryland 21401-1991

Re: House Bill 664

Dear Governor Ehrlich:

We have reviewed House Bill 664, "Biotechnology Investment Incentive Act," which was signed April 26th, for constitutionality and legal sufficiency. We write to discuss significant Commerce Clause issues raised by the bill.[1]

House Bill 664 provides a credit against State income tax for large investments made in qualified Maryland biotechnology companies. In order to qualify, a biotechnology company must have its headquarters and base of operations in Maryland. The tax credit allowed is 50% of the investment, up to $50,000 for an individual, $250,000 for a corporation, and $250,000 for a qualified Maryland venture capital firm. If the tax credit exceeds the total tax otherwise payable, the investor may claim a refund in the amount of the interest. Availability of the refund is dependent on the appropriation of money to the biotechnology investment tax credit reserve fund.[2] A system is set up whereby the Department of Business and Economic Development issues an initial tax credit certificate on a first come first served basis to investors intending to invest in a Maryland biotechnology company. Such certificates may be issued only to the extent that money is available in the reserve fund. Thus, investors know whether the credit will be available at the time that the investment is made.

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[1] This letter confirms and explains oral advice given April 25, 2005.

[2] While the bill purports to require that the Governor make an appropriation to this fund, it does not specify an amount, or set a formula by which an amount can be determined. As a result, the Governor has the discretion not to make any appropriation for this purpose.

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The Commerce Clause of the United States Constitution provides that Congress has the power to "regulate Commerce ... among the several States." United States Constitution, Article I, § 8, clause 3. Although stated as a grant of power to Congress, the Clause has long been understood to prohibit state interference with interstate commerce. *H.P. Hood and Sons, Inc. v. Du Mond*, 336 U.S. 525, 535 (1949). Such interference can arise from state taxation. A State tax will be upheld where it is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to services provided by the state. *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977). House Bill 664 raises issues under the third of these factors: discrimination against interstate commerce.

In *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977), the Supreme Court examined the issue of whether a New York statute taxing securities transactions more heavily if they involved an out-of-state sale violated the Commerce Clause. The Court concluded that it did, stating that one of the "fundamental principles" of Commerce Clause jurisprudence is that a State may not "impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business." *Id.* at 329. The Court found that the differential taxation meant that the choice of stock exchange by persons engaging in large transactions would not be made solely on the basis of nontax criteria. As a result, it acted to give the New York exchange a direct commercial advantage in violation of the Commerce Clause.

More recently, in *Fulton Corporation v. Faulkner*, 516 U.S. 325 (1996), the Court considered a North Carolina statute that imposed a tax on the value of corporate stock owned by State residents, with the amount of the tax varying depending on the exposure of the corporation to the State's income tax. The practical effect was that the tax was low or nonexistent on corporations in the State and significantly higher with respect to corporations that did little or no business in the State. The Court found that the tax facially discriminated against interstate commerce, in that it favored "domestic corporations over their foreign competitors in raising capital among North Carolina residents and tends, at least, to discourage domestic corporations from plying their trades in interstate commerce."

Cases from lower courts have reached similar conclusions. In *Smith v. New Hampshire Dept. of Revenue Admin.*, 692 A.2d 486 (N.H. 1997) *cert. denied* 538 U.S. 1025 (2003), the Court held that an exemption for interest and dividend income from investment in State financial institutions violated the Commerce Clause. Most recently, in *Cuno v. DaimlerChrysler, Inc.*, 386 F.3d 738 (6th Cir. 2004), the Sixth Circuit held that a tax credit for purchases of new manufacturing machinery and equipment if the new machinery or

equipment was installed in Ohio violated the Commerce Clause. This case is being appealed to the Supreme Court (Petition for Certiorari Filed Apr 18, 2005) but the Court has not made a decision whether to take the case.[3]

While none of the cases above are precisely analogous to House Bill 664, it is our view that that bill, which provides a direct commercial advantage to local business, and favors domestic business in raising capital, raises similar significant Commerce Clause issues. Therefore, we would recommend that alternate approaches be considered at a future legislative session.

Very truly yours,

J. Joseph Curran, Jr.
Attorney General

JJC,Jr./KMR/kmr
hb664.wpd

cc: Kenneth H. Masters
Secretary of State
Karl Aro

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[3] The *Cuno* case is the most far-reaching of these cases, in that it reaches tax credits available to out-of-state companies based on activities and job creation in the State, and the broad reach of the case has been questioned. *See* Gillis, *Sixth Circuit: Bans Ohio Tax Credit Under the Commerce Clause*, 101 J. Tax'n 359, 2004 WL 2801135 (December 2004). Whether this extension of the Supreme Court cases is correct, however, is not relevant to the issues raised by House Bill 664.